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ABSTRACT

In the 1980s and the early 1990s Congress failed to approve enterprise zone legislation which sought to help revitalize areas of high unemployment, poverty, and crime and low educational achievement by reducing taxes, relieving regulation, and eliminating other barriers to development. Establishment of comprehensive and sustained enterprise zone programs requires a multibillion dollar commitment by Federal and state government. Enterprise zone bills share three characteristics with previous assistance programs: eligibility criteria, limitation on the number of areas receiving assistance, and delineation of the type and level of assistance offered. Enterprise zone bills have been proposed since 1980. Only in 1987 did Congress authorize the Secretary of Housing and Urban Development to designate up to 100 enterprise zones; this opportunity has since expired. Given other domestic priorities, the two pending enterprise zone proposals are not likely to be enacted. The British enterprise zone program differs from most U.S. proposals, since its objective was the rehabilitation of old industrial sites.
Thirty-seven states and the District of Columbia have enacted enterprise zone legislation. Analyses of these zones have found local commitment essential to their viability. A review of the experiences of five states--Michigan, Virginia, Maryland, Indiana, and New Jersey--indicates that states are ill equipped to revitalize blighted areas alone. The employment and training of zone residents should be a prime consideration for implementing enterprise zone policies. The most effective strategy to empower the residents of blighted communities involves improving their physical surroundings as well as enabling them to acquire education and skills. (YLB)

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March 1992

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CONTENTS

Enterprise Zone Rationale 2
Issues and Proposals 7
- Eligibility Criteria 8
- Limiting Size and Number 9
- Assistance 9

Legislative History 13
Pending Proposals in 1991 14
British Experience 19
State and Local Experience 22
- State Programs 22
- Local Role 29

Experiences of Five States 31
- Michigan 32
- Virginia 35
- Maryland 36
- Indiana 38
- New Jersey 40
- Lessons Learned 43

Empowerment: A Vision Based on Faith 45

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Enterprise Zones: A Promise Based on Rhetoric

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Following deep federal cuts in social programs, President Reagan, in his 1982 State of the Union message, proposed legislation to assist depressed urban areas. "This legislation," he claimed, would provide a "broad range of special economic incentives in the zones [that] would help attract new business, new jobs, new opportunities to America's inner cities and rural towns." Believing that taxes and regulations impeded the innovative potentials of residents and businesses in blighted areas, he advocated tax incentives in enterprise zones, neighborhoods with high concentrations of poverty and unemployment. The proposal found supporters across the political spectrum, ranging from dedicated liberals to the most ardent conservative supporters of the president. All agreed blighted neighborhoods needed help, but they differed on the specifics of how to implement an assistance program.

President Reagan recognized the need to help blighted areas, but he stopped short of actively promoting his enterprise zone proposal. Lacking presidential follow up and support from the chair of the House Ways and Means Committee, Congressman Dan Rostenkowski, Congress failed to pass enterprise zone legislation during the 1980s. Nearly a decade later, in his 1991 State of the Union message, President Bush revived his predecessor's proposal by advocating a federal enterprise zone program. In his 1992 State of the Union message he again included enterprise zones as part of his domestic agenda. His Secretary of Housing and Urban Development, Jack Kemp, has been a tireless proponent of aid to depressed communities and a driving, but unsuccessful, force for the enactment of enterprise zone legislation.

ENTERPRISE ZONES RATIONALE

The fruits of the economic expansion during the 1980s were not universally shared. The prosperity of the suburbs often came at the expense of the neighboring urban areas as people and businesses migrated from cities to suburbs, decreasing the number of jobs available to city residents and eroding the tax base of the cities. In mid-1990, when national unemployment dropped to the lowest level in 16 years, about one-sixth of the metropolitan areas experienced recession level unemployment of 7 percent or higher.

High unemployment, low educational achievements, high levels of poverty, and high crime rates create and define distress in blighted areas. Their populations usually decline as the more affluent and resourceful members of the community move to more favorable environments in the suburbs. This further destabilizes the area by leaving idle people with declining job opportunities stranded in impoverished communities. An underlying theme of the Reagan administration's economic policy was the adage: "a rising tide raises all ships," but blighted areas missed the boat. Despite this fact, the Reagan administration remained steadfast in its belief that depressed communities could only be helped by the private sector and the powers of the free market.

In line with this theory, proponents argue that the application of supply side economic principles is an efficient and effective way to revive blighted areas. This revitalization would be accomplished by reducing taxes, relieving regulation, and eliminating other "government imposed barriers" in depressed neighborhood. Such reforms would, in turn, result in an infusion of capital into distressed areas, leading to more business operations and an overall net gain in investment and jobs.

The appeal of this approach is clear. It involves minimal government resources, and the removal of "big" government. Advocates of unfettered free markets argue that past economic development policies failed because their reliance on subsidies fostered a dependence on government handouts. This, they assert, stifles free enterprise and stymies the potential of small business to revive inner cities.

Advocates believe the seeds of growth already exist in blighted areas because illegal entrepreneurship currently proliferates there. Reducing government financial and regulatory barriers, they argue, will encourage residents to channel their talents from illegal businesses to legal ones.[1] Freed from the shackles of government intervention, indigenous residents in blighted areas would open small businesses and prosper. To bolster the argument that the revival of blighted communities is dependent on job creation by small businesses, they cite several controversial studies claiming 80 percent of all new jobs are created by small firms (100 or fewer employees).[2] In addition, several urbanologists argue that the existence of local street shops and "mom-and-pop" stores is essential to the vitality of urban neighborhoods.[3]

Because enterprise zones bring jobs to labor surplus areas, its advocates advance the belief that the optimum method for helping the unemployed is by bringing jobs to them. A contrasting view is that a more effective method for alleviating unemployment is the relocation of the unemployed to areas with job opportunities. Relocation, however, can only aid the unemployed if they possess the skills required for the jobs. Because many residents in blighted areas are deficiently educated and lack basic skills, the chances that they will have the qualifications to compete successfully to fill job vacancies in prosperous areas are slim. Past government sponsored relocation programs have been short lived. More significantly, mass relocation would involve the abandonment of social capital in the depressed communities and generate demand for new investments in the areas where the relocated workers would settle.

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[1] Carl Horowitz, "New Life for Federal Enterprise Zone Legislation: Seven Lessons from the States" (Washington: The Heritage Foundation, June 4, 1991), p. 1.

[2] David Birch, "The Job Generation Process" (Cambridge, MA: Massachusetts Institute of Technology, 1979); David L. Birch, Job Creation in America: How Our Smallest Companies Put the Most People to Work (New York, NY: Free Press, 1987).

[3] Jane Jacobs, The Life and Death of Great American Cities (New York, NY: Vintage Books, 1961).

Empirical evidence is lacking that reducing federal taxes and relaxing regulations will solve the problems of inner cities. Taxes play at best a secondary role in businesses' investment decisions. Other factors, such as the availability of a skilled labor force, proximity to transportation nodes and markets, local amenities, and the physical security of the sites, are more important to businesses planning to expand or relocate.[4] High unemployment, poverty, and crime levels weigh against investing in blighted areas, as do their dilapidated infrastructure and inferior local services and amenities. As one liberal congressional supporter of enterprise zone legislation stated, "[I]t's going to take more than a tax incentive to cause people to go into a bombed out economic disaster area and believe that they can make a buck."[5] Modest tax incentives and deregulation alone do not provide adequate inducements to offset the deterrents of locating in a blighted area.

A free market approach to revitalizing blighted areas ignores the needs of residents in enterprise zones. Many need education and training to qualify for work; they lack the skills for all but the lowest paying entry level jobs. The absence of a job ready labor force in most blighted areas encourages businesses locating in a zone to hire workers from outside the area. Importing employees to work but not to live in a zone does not decrease unemployment in the area or empower zone residents.

The job generation capacity of small businesses has also been challenged. Although few dispute that small

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4 Marc Bendick, Jr. and David W. Rasmussen, "Enterprise Zones and Inner-City Economic Revitalization," in Reagan and the Cities, George E. Peterson and Carol W. Lewis, (eds.) (Washington: Urban Institute Press, 1986), p. 107; Patrick G. Marshall, "Do Enterprise Zones Work," Editorial Research Reports (Washington: Congressional Quarterly, April 28, 1989), p. 235.

5 Charles Rangel, Hearings before the U.S. Congress, House Ways and Means Committee, "Administration's Enterprise Zone Proposal and HR.6, The Enterprise Zone Improvement Act of 1989" (Washington: Government Printing Office, October 17 and 18, 1989), p. 79.

businesses play an integral part in maintaining the nation's economic health, claims that they are responsible for eight out of every ten new jobs generated are exaggerated.[6] Small and start-up businesses are inherently unstable, and their mortality rate is high. Those able to stay afloat often are unable to offer their employees the wages, health benefits, and job opportunities that their larger counterparts are able to provide. Even if an increase in small business activity were needed to revitalize blighted areas, tax incentives and deregulation would have, at best, a nominal impact. Most entrepreneurs do not decide to start a business because of marginal tax relief. In addition, most small businesses would be unable to utilize the tax incentives offered in proposed enterprise zone legislation. Few businesses in their early years have the tax liabilities needed to take advantage of non-refundable tax breaks.

The sharp distinction that supply-side adherents draw between tax exemptions and direct subsidies is equally unpersuasive; both policies distort free market operations. Enterprise zones are subsections of larger economic markets, yet the tax breaks and deregulation apply only to the zones. Enterprise zone theory is premised on the government intervening in the market so as to favor a geographic area. The subsidies that go with designation may diminish the competitive capabilities of firms outside the boundaries of the zone. Due to government intervention, these firms will have a distinct disadvantage compared to their zone competitors.

Compared with direct subsidies, revenue forgone through the tax code is normally an ineffective mechanism for revitalizing blighted areas. Tax expenditures proposed in enterprise zone legislation have few strings attached to their uses. There is no guarantee the savings accrued through the tax code will be spent in the zone. A company can choose to pocket its profits rather than reinvest in the zone or hire zone employees. Direct government grants or subsidized loans usually provide safeguards, requiring subsidies be used for their intended purposes.

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[6] Charles Brown, James Hamilton, and James Medoff, Employers Large and Small (Cambridge, MA: Harvard University Press, 1990), p. 2.

Programs grounded in free market approaches lacking appropriate incentives are not likely to induce new investments in blighted areas that will result in the revitalization of the communities. Capital can flow into a zone without benefiting the community and its residents. For example, the relocation or construction of warehouses in zones is of little value to the community as is the relocation of a firm whose employees are not zone residents and whose profits are spent outside the zone.[7]

The creation of opportunities for its residents to become economically self-sufficient is a necessary condition for reviving a blighted community. Tax expenditures will not reduce the concentration of welfare recipients living in the zones. Programs advancing the ability of potential workers to become self-supporting will. Since a significant portion of potential workers are families dependent on welfare, federal programs directed at improving their educational achievements, health, and skills should constitute an integral part of enterprise zone efforts. Potential workers need to master the 3Rs if they are going to compete in a job market that increasingly demands a literate workforce. Several federal programs have proved effective in assisting impoverished children and their families. The Women, Infants and Children (WIC) program channels perinatal care to low income expectant and new mothers and their children, while providing them with a balanced diet. Head Start prepares children from poor families, aged three to five years, for a successful educational career. Compensatory education provided under chapter 1 of the Education Consolidation and Improvement Act, is another education program that has a proven track record in improving educational achievements of low income children. While the federal government already funds these programs, they need to be adapted and expanded for the special needs of blighted areas. Bringing businesses and jobs to zones without preparing the residents for work will only marginally decrease unemployment and will not empower residents. The converse is also true: preparing residents for work without expanding employment opportu-

[7] J.F. Hornbeck, "State Enterprise Zones and Economic Redevelopment: Implications for the Federal Program" (Washington: Congressional Research Service, October 10, 1989), p. 4.

nities is futile. Business investment decisions are predicated on the physical infrastructure of an area, its skilled labor supply, as well as its social amenities, not its tax rate. Direct expenditures, not tax incentives, are needed to improve an area's physical appearance and make it attractive to potential businesses.

In brief, vague promises of improvement and sermons on the virtues of free markets will not create viable enterprise zones. The establishment of comprehensive and sustained programs will, and this will require a multibillion dollar commitment by federal and state governments.

ISSUES AND PROPOSALS

Federal assistance to depressed labor markets dates back to the passage of the 1961 Area Redevelopment Act (ARA).[8] The ARA was followed by several other initiatives aiding depressed areas and neighborhoods, including urban renewal, the model cities program, and urban development block grants. The notion of using enterprise zones to assist blighted areas entered the U.S. policy arena in 1980, when Ronald Reagan called for their establishment while campaigning for the presidency. He claimed the enterprise zone program was a radical departure from previous economic development programs that had failed. The sponsors of the initial enterprise zone bill, the Urban Jobs and Enterprise Zone Act of 1980 (HR.7240), also assumed their proposal was distinct from past programs because it did not involve entitlements. The rhetoric surrounding enterprise zone proposals has not changed during the dozen years since the introduction of the first bill. Past and present enterprise zone bills, however, share three characteristics with previous assistance programs. First, they spell out the eligibility criteria that qualify depressed areas for designation. Next, they limit the number of areas receiving assistance. The third component delineates with the type and level of assistance the

8 Sar A. Levitan, Federal Aid to Depressed Areas (Baltimore, MD: The Johns Hopkins Press, 1964).

government offers blighted areas. Similar requirements marked previous programs aiding depressed areas.

Eligibility Criteria

An enterprise zone program must determine the areas, businesses, and individuals eligible for federal aid. The ARA, for example, used only chronic high unemployment as a criterion for the qualification of an area. Proposed enterprise zone legislation also base eligibility on poverty rates and income levels. In contrast to ARA, which designated broad labor market areas or counties, enterprise zone bills propose to assist neighborhoods within cities, counties, or labor markets. Data on subareas of cities and counties are typically nonexistent, and potential designation of enterprise zones would be based on highly speculative data. A specifically designed survey would be needed to obtain credible statistics for potential enterprise zones. Even if "good" data were available, the federal thresholds for poverty are unsuitable for the purposes of designating enterprise zones. Costs of living vary widely not only from urban to rural areas, but among urban areas. Unemployment rates also have their flaws. They only count individuals who are idle but seeking employment. They do not include individuals who are neither employed nor looking for work, and they count part-time workers as employed. These are significant shortcomings as far as designating potential enterprise zones is concerned. In addition, unemployment rates may not be a reliable indicator of distress because in some locations people tend to leave an area when employment opportunities decline and out-migration is not reflected in unemployment rates. In many communities, especially rural areas, high out-migration rates are better indicators than job deficits, and some of the enterprise zone bills have incorporated this factor. The data deficiencies, however, have not deterred Congress from passing legislation based on equally unreliable data and would not prevent it from enacting enterprise zone legislation if it could agree on a program.

In general, currently proposed enterprise bills require potential non-rural zones to possess a population of at least 4,000, an unemployment rate exceeding the national average by 50 percent, and 20 percent of the population living in poverty. In addition, some bills require at least 70 percent of households in designated areas have incomes below 80

percent of the household area's median income, or a decline in the area population of 20 percent during the two latest decennial census. These criteria are broad and would qualify areas in excess of the number a viable program could handle.

Limiting Number and Size

In order not to spread resources too thinly, a realistic enterprise zone bill would have to limit the aggregate number of zones. Consequently, the number of zones proposed in currently pending bills ranges from 25 to 100. Subject to several subjective guidelines, the bills authorize the Secretary of HUD to choose among qualified areas. These guidelines include the strength and quality of commitment to the program by the state and local governments, the effectiveness and enforceability of the proposed local/state action, the level of support and commitment by local private entities, and the areas with the greatest likelihood of success or potential for revitalization. These criteria are vague, allowing the secretary wide flexibility in choosing zones and opening the selection to charges of political favoritism. A more practical policy might be to make the initial eligibility criteria more stringent. Raising the levels of unemployment and poverty rates would restrict the number of eligible zones and confine zones to truly blighted areas. This approach, however, may be self-defeating because chronically depressed areas are less likely to become "successful" enterprise zone.

Determining the boundaries of an enterprise zone is a formidable challenge. Census tracts are not designed for this purpose and are not suitable for setting community boundaries. "Natural" boundaries--rivers, railroad tracks, and highways--are equally unsuitable borders. Viable zones will have to include residential areas as well as sites appropriate for retail, wholesale or industrial establishments. In the absence of general rules, setting the boundaries for enterprise zones will have to be determined on a case by case basis that will require many arbitrary decisions.

Assistance

The two major policy options for administering aid to designated areas are tax expenditures and direct subsidies. Current enterprise zones bills propose only the former--a series of tax cuts and relaxation of government regulations. Liberal supporters of this approach have endorsed tax

expenditures because direct subsidies, if enacted, are likely to draw a presidential veto. That leaves them with no other options beyond tax expenditures.

The enterprise zone bills introduced over the past ten years have proposed a variety of tax expenditures that provide tax subsides to employees, employers and investors. Tax credits offered to employees are confined to low-income employees usually, but not always, residing in the zone. Current bills cap this credit at $525 per person annually. The credit supplements the earned income tax credit available to low wage earners. The effectiveness of the credit is likely to be marginal. While it will augment the income of the working poor, the amount offered is unlikely to induce unmotivated individuals or welfare recipients to seek employment.

Two tax incentives are offered to employers. First is a tax credit of up to 50 percent for wages paid to economically disadvantaged zone residents during the first three years of their employment. After the initial three years, the credit would be phased out. The credit is intended to reimburse employers for hiring individuals with low skills and initial low productivity. It also helps offset the risk of hiring individuals with marginal commitments to stable employment. If properly used, the credit would benefit the community by decreasing its unemployment and moving welfare recipients from dependency to economic self-sufficiency.

The second employer tax credit would provide them with a 10 percent credit for wages paid to all new employees, regardless of where the hired employees live or their economic condition. The credit would reward employers for expanding their workforce. Its benefits to the community, however, are uncertain. A firm could locate in the zone, hire only non-zone residents, and still receive tax credits. A Congressional Research Service study of labor incentives indicated that when targeted and non-targeted tax credits for employee hiring are used in tandem, the incentive to hire disadvantaged individuals is decreased.[9] In addition, federal

[9] Dennis Zimmerman, "Federal Tax Incentives for Enterprise Zones: Analysis of Economic Effects and Rationales"

experience with subsidizing employers for hiring disadvantaged workers under the targeted job tax credit law strongly suggests that the credit may result in a windfall to employers without helping the intended beneficiaries of the law.

The third recipient of proposed tax subsidies is the investor in enterprise zone businesses and real estate. Tax savings for investors include deductions on capital gains taxes, purchases of stock in enterprise zone business, and credits for investments in real estate. These subsides are premised on the belief that the tight supply of capital in blighted areas is partially responsible for their economic stagnation. Advocates claim capital-based tax concessions will promote economic activities in zones by increasing the capital available to potential and existing businesses.

The Reagan and Bush administrations have urged decreasing or eliminating taxes on all capital gains, anticipating the action will stimulate economic growth by increasing investors net returns and capital for new investments. Applied to enterprise zones, proponents argue that reducing, deferring, or eliminating taxes on capital gains would stimulate economic growth in enterprise zones, provided the gains are reinvested in a zone. Some bills qualify firms for capital gains benefits only after they have done business in the zone for two years. Others allow capital gains to be deferred provided they were reinvested in the zone for a specified time period. Whatever the specific circumstances, whether decreasing taxes on enterprise zone capital gains justifies the potential drain on the U.S. Treasury is debatable. The only direct beneficiaries in zone communities from the reductions in capital gains taxation would be property owners able to sell their land at a profit. Their gain, however, may be their neighbors' loss. Renters in the area--the majority of residents--might experience rising rents due to the increase in land prices. Another negative consequence of this tax concession will be a windfall gain to investors who would have invested in the community in the absences of tax breaks. In brief, the case for reducing capital gains taxes in enterprise zones is even less persuasive than

(Washington: Congressional Research Services, June 15, 1989).

overall cuts for capital gains taxes.

A tax credit or deduction for stocks purchased in zone enterprises is another subsidy that benefits investors. In theory, these investments will stimulate economic activity in the zone by encouraging investors to buy corporate stock in zone businesses and provide venture capital to new companies. Proponents claim the deductions are needed to compensate for risky investments in stocks issued by companies located in enterprise zones. The direct benefit to the community of these deductions is also doubtful. Increases in stock investments may lead to new or expanded business, which in turn may lead to new job opportunities for residents. Much of this new investment, however, might have occurred in the absence of the tax incentives, and would benefit the investors, not the community. It is extremely difficult to create new investment without subsidizing old investment and wasting tax dollars. Also, such deductions would not help small businesses because they normally obtain their initial capital from friends, family, loans, or by investing their own savings. They rarely issue corporate stock to obtain capital. If the goal is to encourage "risky" investments in enterprise zones, there are better methods. Increasing the returns on successful investments by expanding the provisions for offsetting losses, for example, is a more effective incentive to induce investors to take risks in enterprise zones.[10]

Credit for investments in zone real estate is another proposed tax break. The rationale for the tax credit is to encourage firms to upgrade physical sites that would have remained unattended without the incentives. Assuming that investors would not have acted in the absence of incentives, this tax break may induce firms to invest in the property and continue their businesses in the zone after the exemptions lapse. This would have a lasting and positive effect on the area's economic viability.

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10 U.S. Congress Joint Tax Committee, "Description of Enterprise Zone Proposals (HR.6 and Administration Proposal)" (Washington: Government Printing Office, October 14, 1989), pp. 24-26.

LEGISLATIVE HISTORY

Congressmen Jack Kemp and Robert Garcia introduced the first enterprise zone bill in 1980. This was an unusual couple to sponsor a bill. Jack Kemp was an adherent of supply side economics, while Robert Garcia was a liberal Democrat from the South Bronx. They proposed tax credits to employers, employees, lending institutions, and investors. President Reagan offered an alternative proposal nine months after Kemp and Garcia reintroduced their enterprise zone bill in 1981. He urged the provision of "...services through increased reliance on decentralized, voluntary, private, market institutions rather than highly centralized bureaucratic, coercive government institutions."[11] To achieve this end, the Reagan bill proposed larger tax breaks to employers and lesser credits to employees than the Kemp-Garcia Act. It also emphasized credits for investments in construction/ rehabilitation of building and/or depreciable real property.

Believing government regulations burdened businesses as much as taxes, the Reagan administration proposed complementing tax exemptions with the elimination of some government regulations. The proposal authorized executive agencies to rescind regulations hindering businesses that were not mandated by federal statute. Claiming the minimum wage contributed to high youth unemployment by pricing them out of potential job opportunities, the proposal urged Congress to establish a subminimum wage rate for teenagers employed by zone businesses. The provision was the most controversial aspect of the Reagan proposal and was dropped from subsequent administration backed enterprise zone bills.

The Republican-controlled Senate passed enterprise zone legislation embodying most of Reagan's proposals in 1983, 1984, and 1985, as did the Democratic controlled Senate in 1987. The Democratic controlled House, however, did not act on any enterprise zone bill. Reagan's Secretary of HUD, Samuel Pierce, displayed little interest in enterprise zones and most legislation aimed at helping the urban poor.

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[11] Internal White House Memorandum, The Administration's Plan for Enterprise Zones, January 6, 1982.

Democrats who might have been inclined to support enterprise zone legislation were reluctant to support the bill, charging that the administration was advocating the legislation to justify cuts in other urban assistance programs. Opposed to enterprise zone legislation, Congressman Rostenkowski, chairman of the House Ways and Means Committee, blocked hearings on the subject. The chairman's opposition prevented House action of any enterprise zone legislation. In 1987 Congress did authorize the Secretary of HUD to designate up to 100 enterprise zones. The action, however, was meaningless because it failed to include any direct or indirect funding for the program. Secretary Jack Kemp refused to designate any zones because federal legislation was lacking "teeth." The opportunity for the secretary to designate zones has since expired.

PENDING PROPOSALS IN 1992

*P*rompted by Secretary Kemp, the Bush administration has indicated an interest in promoting enterprise zone legislation. To secure bipartisan support, the Bush administration obtained the cooperation of Congressman Charles B. Rangel, a senior Democratic member of the House Ways and Means Committee. He introduced the first Bush enterprise zone bill and reintroduced it in 1991 (HR.23). A committed liberal Democrat from Harlem who finds little solace in free market economic policies as a means of revitalizing blighted areas, Rangel is also an unusual partner for a Republican sponsored initiative. Senator John Danforth, a Republican, introduced a companion bill to HR.23 (S.1032). The two bills call for the designation of 50 zones over three years and offer three tax incentives:

- a 5 percent refundable tax credit paid to zone residents earning less than $20,000 annually, with a maximum annual credit of $525 per employee;
- the exclusion of capital gains derived from zone property assets accrued by businesses that have operated in the zone for at least two years

prior to gain realization; and

- o deductions of current investments in newly issued corporate stock with less than $5 million in assets. Deductions against income tax would be limited to $50,000 annually per investor with a life time limit of $250,000.

The bill permits federal agencies to waiver regulations in zones, provided they are in accordance with federal statues. This self-contradictory provision is an empty gesture, paying tribute to the original ideology behind enterprise zones.

In 1990 Congressman Rostenkowski relented in his opposition of enterprise zones and introduced an enterprise zone bill. He reintroduced a similar bill in 1991 (HR.11). Rostenkowski claimed past bills were "giveaways" to business, devoid of social benefits and would have constituted an unwarranted drain on the federal treasury. His skepticism about enterprise zones is reflected in his bill. First, it is a pilot project, authorizing the Secretary of HUD to designate only 25 zones. Second, he places a limit on the tax expenditures. Each zone receives an initial $10 million plus the proportion of its population to the total population of the zones from an annual allocation of $50 million. The formula would, on average, provide $20 million per zone. The Rostenkowski bill offers the following five incentives:

- o tax credits to businesses with less than 100 employees equal to 10 percent of wages and health benefits paid to zone residents who earn less than $30,000 annually;
- o rehabilitation credits for investments in buildings over thirty years old;
- o deferral of capital gains taxes earned on the sale of any tangible property or equity invested in the zone for at least five years (provided the profits do not exceed $250,000);
- o allowance of the loss on any stock or debt security in a zone corporation to offset ordinary losses, rather than being limited to offsetting capital gains; and
- o credit for rehabilitation of buildings that contain child care facilities and 60-month amortization of child care facilities.

The administration/Rangel (HR.23) and Rostenkowski (HR.11) bills use tax expenditures to further economic development but differ in their choice of allowable tax expenditures. Rostenkowski's bill would reward employers for hiring zone residents while the administration's bill offers a subsidy to employees. The administration's bill proposes the elimination of capital gains taxes for investors on tangible zone assets. Rostenkowski's bill proposes deferring any capital gains taxes provided the gains are reinvested in the zone. Recognizing that the lack of adequate and affordable child care is a deterrent to low income mothers seeking employment, Rostenkowski's bill offers financial aid to help establish child care facilities within the zone. It is highly doubtful, however, that the meager incentives offered by Rostenkowski would be adequate in attracting child care facilities to blighted areas.

The major difference between the two bills is the cap Rostenkowski places on the amount of tax incentives available to businesses (table 1). The provision is intended to preclude the escalation of program costs and apparently reflects his skepticism about the effects of providing tax cuts without strings. Rostenkowski may have been thinking of the unforeseen costs that arose from tax-free industrial development bonds when he placed a cap on tax-rebates in his enterprise zone legislation. Before they were restricted, tax-free industrial development bonds accounted for significant revenue loss to the federal government without commensurate returns. Secretary Kemp, however, vehemently opposes placing a cap on the dollars spent for the program. The cap, he argues, would involve the government designating a local "zone czar" to allocate tax subsidies, stymieing free enterprise, a necessary condition, Kemp believes, for an effective enterprise zone initiative. Secretary Kemp conveniently ignores the fact that by selecting a limited number of areas to receive federal assistance, the Secretary of HUD himself implicitly becomes a zone czar. In addition, he still clings to the notion that in the long run enterprise zones will be a revenue enhancer, creating new businesses that will pay taxes and will provide jobs for the unemployed and welfare recipients, thus reducing AFDC outlays.

TABLE 1. Comparison of Administration and Rostenkowski Bills.

Provisions	Administration/ Rangel (HR.23) and Danforth (S. 1032) bills	Rostenkowski (HR.11)
Job credit for employer	None	10% of wages and health insurance paid to zone residents
Refundable tax credit to employees	5% of qualified wages with annual maximum of $525 per worker	None
Stock deductions	Stock purchase deduction from ordinary losses	Deductions of worthless stock
Capital gains	Permanent exclusion	Deferral of capital gains
Financing of child care facilities	None	60 month amortization and rehabilitation credits

Many assumptions, some arbitrary, have to be made in order to estimate the costs of the proposed legislation. Given the size and caps of the Rostenkowski bill (HR.11), a ball park estimate by the Congressional Joint Tax Committee has placed the costs of HR.11 over four years at $2 billion with the following breakdown:

- o $200 million, 1st year;
- o $400 million, 2nd year;
- o $600 million, 3rd year;
- o $800 million the 4th year.

The administration's bill (HR.23) allows 50 zones, double the number authorized in HR.11. This implies its costs would be

at least double that of HR.11. HR.23, however, imposes no caps on the generous incentives it offers. Its costs will remain uncertain, but could initially deplete the Treasury by 10 times the amount estimated for the Rostenkowski bill, depending on the zones that are designated, the level and type of investment in the zone, and the number of employees hired, just to name a few variables. In the absence of a cap, unlimited capital gains investors may put up new buildings, displacing the old residents and driving them out of the zones. Of course, successful zone policies would bring returns to the Treasury, but at this stage such an assumption is speculative. More significantly, the chances an enterprise zone program will limit designation to 50 zones is slim. A Heritage Foundation study, for example, recommended the designation of 100 zones.[12] This would further raise costs.

The Reagan and Bush administrations have repeatedly proposed enterprise zone legislation, but neither administration considered the program a priority item. In line with the 1990 deficit reduction legislation enactment, the program would entail either a commensurate cut in other discretionary domestic programs or a tax increase, and neither alternative is palatable to the administration. A handful of Democrats also support enterprise zone legislation, but they have let the administration take the lead in finding the funds for implementing the program. It seems unlikely that a majority of both houses will be willing to sacrifice scarce funds from established and proven social programs to experiment with an initiative grounded in supply-side economics. Given other domestic priorities, the pending enterprise zone proposals are not likely to be placed on the top of the administration or Democratic favorite list.

12 Horowitz, p. 12.

BRITISH EXPERIENCE

The enterprise zones idea is an import from the United Kingdom. In 1977 a British academic, Professor Peter Hall, advanced the notion of decreasing government intervention in business operations in sections of blighted inner cities. Convinced that existing programs had failed to combat the stagnation of old industrial cities, Professor Hall advocated creating "freeports" in depressed areas where "shameless" free enterprise would guide economic forces. The support for his idea came from the economic success of freeports like Hong Kong and Singapore. Without presenting evidence, he attributed their prosperity to their lack of government taxes and regulations. Believing that the plight of decaying inner cities called for radical measures, he proposed creating British freeports by designating a few blighted areas in inner cities where "bureaucracy would be kept to an absolute minimum."[13] His ideas were dismissed by the Labor party as being too extreme, but Geoffrey Howe, then Chancellor of the Exchequer in the Thatcher government, found merit in them.[14]

In 1980, the British Parliament passed enterprise zone legislation, and within three years designated 25 zones in desolate industrial areas. The British government offered businesses a four part, ten-year incentive package:

- exemption of industrial, commercial and retailing property from property taxes,
- exemption of the sales of undeveloped lands from development land taxes;
- offsetting expenditures on industrial and commercial buildings against the British equivalent of capital gains taxes; and
- simplification of local planning and zoning processes, including reduced statistical reporting.

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13 Peter Hall, "The British Enterprise Zone" in Enterprise Zones: New Directions in Economic Development, Roy E. Green (ed.) (Newbury Park, CA: Sage Publications, 1990), pp. 181-182.

14 Stuart M. Butler, Enterprise Zones: Greenlining the Inner Cities (New York, NY: Universe Books, 1981), pp. 95-129.

Several studies of British enterprise zones indicated that the incentives stimulated development and economic activity within the zones. The British program encouraged firms to renovate old industrial sites, which helped expand the economic base of the zones. By 1987 over 4,300 firms were operating in British zones. The majority of businesses (88 percent) located in the zones were small businesses employing 50 persons or less. Of all businesses operating in the zones, 25 percent were start-up businesses.[15] There is little evidence, however, to indicate that these new firms would not have started without the incentives. One study found three out of four businesses were either start-up or established businesses attracted from nearby areas that would have located in the zone without the incentives.[16] Another study claimed only 12 percent of start-up business in the zone was due to zone incentives.[17] In addition, these studies indicated that most (80 percent) of the relocated firms were from the zone region, many of which considered moving to the zone prior to designation. It appears much of a zone's success came at the expense of the neighboring areas.

Zone businesses created a total of 63,300 jobs. Only 35,000 of these jobs, however, were found to be a direct result of enterprise zone policies. Employment losses in areas surrounding zones that resulted from zone policies further reduced the net total job creation to under 13,000.[18] None of

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15 Jonathan Talbot, "Have Enterprise Zones Encouraged Enterprise? Some Empirical Evidence from Tyneside," Regional Studies, Vol. 22, No. 6, 1988, pp. 507-514; John E. Schwarz and Thomas J. Volgy, "Experiments in Employment: A British Cure," Harvard Business Review, March-April 1988, pp. 104-112; William D. Gunther and Charles G. Leathers, "British Enterprise Zones: Implications for U.S. Urban Policy," Journal of Economic Issues, June 1987, pp. 885-893; Seqal Quince, "Evaluation of Employment Enterprise Zones: Final Report to the Commission of the European Community" (Luxembourg: Winchester Limited, 1990), p. 14.

16 Schwarz and Volgy, p. 106.

17 Gunther and Leathers, p. 889.

18 Great Britain Department of the Environment, "An

the studies indicated how many of these jobs went to economically disadvantaged individuals. The economic growth in British zones did not come cheaply. One study estimated that between 1981 and 1986, the program cost the British government 297 million pounds. (82 million pounds in rate relief, 150 million pounds in capital allowance, and 65 million pounds in public expenditures that would not have been undertaken without zone subsidies.) Each job is estimated to have cost the British government between 23,000 - 30,000 pounds ($42,500 - $55,500 at the January 2, 1992 exchange rate), depending on whether construction jobs are included. The higher estimate excludes construction jobs, but provides for a multiplier effect.[19]

After almost ten years, the British government decided to phase out its enterprise zone experiment. The tax incentives for the initial 12 zones expired in 1991, and the second round will terminate in 1993-94. Since the selection in 1983-84, only two other zones have been designated, both in 1989. Around 1987, the British government began supporting other redevelopment mechanisms, especially urban development corporations, which are locally controlled planning authorities that acquire, reclaim, renovate, and sell public and private lands.

The British enterprise zone program differs from most U.S. proposals. The implied goal of the British program was the rehabilitation of old industrial sites through new construction and restoration, so the designated zones were located in scarcely inhabited areas. In this respect the program was successful. In contrast, the stated goal of proposed U.S. programs is community revitalization through increased economic activity and the creation of jobs for zone residents. A U.S. policy, if enacted, would have to address the problems associated with urban blight, such as drugs, crime, and a deficient education system. The abandoned British program offers little enlightenment or encouragement for Congress to enact an American program. It may, therefore, be instructive to examine the state and local experiences for the lessons they might offer for a federal program.

Evaluation of the Enterprise Zone Experiment" (London: Her Majesty's Stationery Office, 1987), p. 86.

[19] Hall, p. 187.

STATE AND LOCAL EXPERIENCE

A basic tenet of the Reagan and Bush administrations was and is "the New Federalism," which has entailed a shift of control and responsibility for social programs from the federal government to state governments. In response to this shift, states have been forced to bear more of the responsibility for the social welfare of their residents. Although states have traditionally pursued economic development policies, the recent expansion of their obligations has led them to explore new initiatives including enterprise zones. State enterprise zones sought to create jobs through market interventions and tax rebates. City and state governments have often offered businesses corporate or property tax reductions to induce them to locate in their cities, and thus generate new jobs for their residents and expand the jurisdictions' tax base. In this respect, enterprise zone programs are not a new initiative, merely targeting tried policies to confined areas. Thirty-seven states and the District of Columbia have enacted enterprise zone legislation during the past decade to combat the blight of inner city and rural areas.

State Programs

While pending federal government legislation relies on free market policies bolstered by tax breaks for its proposed initiative, state governments have taken an interventionist approach to enterprise zone programs. States have attempted to redirect investments to blighted areas, change financial regulations to encourage lending institutions to make investments in zone enterprises, earmark public pension funds for enterprises zone venture capital or development funds, as well as offer businesses various tax breaks. While the diversity of economic development tools for state enterprise zone programs results in a more varied assistance package, the total resources allocated for the zones are meager.

Given the differences in resources and tax structures, states' incentives enacted to promote enterprise zone policies differ from those proposed in the pending federal bills. For example, states frequently encourage the relocation of out-of-state firms into enterprise zones as a means of expanding their

economic base. The federal government, in contrast, tends to discourage or prohibit the relocation of industries from state to state as part of its enterprise zone program. From a national vantage point such relocation is a zero-sum gain and politically controversial.

In the absence of federal guidelines, states have enacted widely diverse programs under the umbrella of "enterprise zone." For example, Michigan has only one enterprise zone while Louisiana has over 800. Pennsylvania's enterprise zone program was established administratively while the rest were legislatively enacted. Two encompassing objectives emerge from the diversity of state enterprise zone programs: economic growth and social development.[20] Six major indicators of blight predominate as criteria for determining area eligibility: unemployment levels, declines in population, poverty levels, median incomes, percentages of welfare recipients, percentage of abandoned buildings, and population size.[21]

As in the pending federal bills, state eligibility criteria are often broad and qualify a larger number of areas than could effectively be selected. The process used by states to choose among potential zones is often driven by political considerations rather than a thoughtful design of a viable enterprise zone policy. Louisiana, for example, allows 25 percent of its census tracts to become enterprise zones. Illinois originally limited its program to 48 zones, however, when a larger number of areas applied, the state increased the number of zones to over 100 zones. It has even considered making the entire state an enterprise zone. In contrast, only sections of Atlanta are eligible to be designated as an enterprise zone in Georgia. Florida initially designated all areas that applied and met its criteria for zone selection. After approving over 100 zones, the state revised its legislation and limited designation to 20 competitive zones. Minnesota has two types of zones, competitive and border zones. The latter

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20 J.F. Hornbeck, p. 4.

21 Rodney A. Erickson and Susan W. Friedman, "Enterprise Zones: An Evaluation of State Government Policies" (Washington: U.S. Department of Commerce, April 1989), pp. 24, 26, 33-35.

applies to cities bordering continuous states while the former areas compete for designation. The majority of states use a competitive process similar to the one proposed in federal legislation, basing selection primarily on their level of distress in the area and the level of local commitment to the program.

Incentives offered by states to their enterprise zones fall into three categories: investment, financial and labor (table 2).

TABLE 2. State enterprise incentives.

Investment	Finance	Labor
Sales/use tax	Investment funds	Employer credit for all new hires
Franchise tax	Industrial revenue development bonds	Employer credit for economically disadvantaged new hires
Investment tax credit	Financial packages	Employee credit
stock	Debt financing	Job training tax credit
property		
capital gains		
Employer tax rebate:	Reduced taxes on venture capital funds	Unemployment insurance rebate
corporate inventory		
unemployment	Tax increment financing	

Sources: Rodney A. Erickson and Susan W. Friedman, "Enterprise Zones: An Evaluation of State Government Policies (Washington: Department of Commerce, 1989); U.S. Department of Housing and Urban Development, "State Enterprise Zone Update: Summaries of State Enterprise Zone Programs" (Washington: U.S. Department of Housing and Urban Development, 1987-1988).

Investment incentives, designed to bring capital into the region, are the most widely used. The highest ranked incentive by state zone coordinators is the exemption of business-related purchases from state sales and use taxes. The state coordinators opined that these tax breaks are most effective in promoting economic development because businesses do not need to incur tax liabilities to benefit from this provision (table 3). Small and new companies normally operate at the margin and this tax break can relieve some cash flow problems for them. The other tax concessions used by states to augment investments in their zones are business and tax credits/exemptions, income tax exemptions on capital gains, tax deductions for investments in stock and property, and employer tax credits.

TABLE 3. Most frequently offered development incentives for 22 states.

Program feature	Number	States
Sales and use tax exemption for building materials, equipment, and machinery	12	Alabama, California, Colorado, Connecticut, Florida, Illinois, Kentucky, Minnesota, Missouri, New Jersey, New York, Texas
Tax credit for each new employee hired	10	California, Colorado, Connecticut, Maryland, Minnesota, Missouri, New Jersey, New York, Ohio, Vermont
Availability of employee training	9	Alabama, Connecticut, Indiana, Missouri, New Jersey, New York, Oregon, Pennsylvania, Vermont
General property tax reduction for firms locating or expanding in the zone	9	Colorado, Connecticut, Florida, Indiana, Maryland, Minnesota, Pennsylvania New York, Ohio,
Corporate income tax reductions	9	Alabama, Colorado, Connecticut, Indiana, Missouri, Ohio, Pennsylvania, Utah
Infrastructure improvements	8	Alabama, California, Connecticut, Illinois, Missouri, New York, Pennsylvania, Vermont

Source: U.S. Department of Housing and Urban Development, "Survey of 22 State Enterprise Zone Coordinators," unpublished (Washington: U.S. Department of Housing and Urban Development, April 1989), p. 9.

In the absence of sufficient experience, the effectiveness and benefits of these tax breaks remains questionable. Over half the states favor investment-oriented incentives rather than labor and financial incentives. For example, investment tax breaks accounted for 80 percent of the cost of the New Jersey program and 88 percent of the Indiana program.

The second category, financial incentives, creates innovative methods for funding business endeavors in enterprise zones. Subsidies include reducing taxes for interest earned on loans to zone enterprises, debt financing plans, tax increment financing, and set-asides of industrial development bonds.

Pennsylvania offers only financial incentives and state grants to its zones. Each of its initial seven zones received a $250,000 grant from the state. In the next round, 12 zones (including five from the previous round) received grants ranging from $150,000 to $825,000. The state offers no formal guidelines but requires each applicant to submit a three-year development plan demonstrating local, private and public commitment, and how the grants will best benefit the area. Uses of the grants include: infrastructure improvements, low-interest loans to businesses, promotional campaigns, equity capital, residential improvements, and construction of incubator sites. In addition to grants, the state offers enterprise zones priority when applying for funding from state programs like bridge repair, neighborhood assistance, and minority business development.[22] One study concluded that Pennsylvania's enterprise zone program is fairly successful compared to other state programs.[23] This

[22] U.S. Department of Housing and Urban Development, "State-Designated Enterprise Zones: Ten Case Studies" (Washington: Government Printing Office, August 1986), pp. 216-221.

[23] Erickson and Friedman, pp. 84, 94.

finding may be significant because Pennsylvania offers businesses grants and preferential treatment in awarding state grants-in-aid, but no tax rebates or credits.

Wage and training incentives, the third category, parallel those offered in proposed federal legislation with one exception. Several states offer tax credits to companies that provide job training programs. The survey of state coordinators rated job training as an important component in enterprise zone programs. This incentive is conspicuously missing from all proposed federal legislation. While the federal government offers 100 percent subsidized job training through the Jobs Training Partnership Act (JTPA), the program is not specifically directed at blighted communities, nor do the proposed federal bills provide preferential treatment to enterprise zones in the allocation of JTPA funds. Worker training programs are not without their flaws. There have been several reports indicating that funds for training programs often become outright subsidies to businesses.[24]

States also provide enterprise zones non-tax related assistance, including the technical and managerial help, coordination of federal programs and grants, and marketing and promotional efforts. Pending federal proposals have ignored benefits of the potential non-tax related aid to potential zones. Marketing, for example, has been singled out as an important component of "successful" zones.[25] Virginia's zone coordinators and participating companies commented that the lack of marketing assistance was responsible, in part, for the scant interest in the program.[26]

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24 U.S. Congress, Office of Technology Assessment, Worker Training: Competing in the New International Economy, OTA-ITE-457 (Washington: Government Printing Office, September 1990), p. 149; Susan B. Garland, "90 Days to Learn to Scrub? Sure If Uncle Sam's Paying," Business Week, January 20, 1992, pp. 70-71.

25 U.S. Department of Housing and Urban Development, "State-Designated Enterprise Zones," p. ix.

26 Virginia Department of Housing and Community Development, "Virginia Enterprise Zones: Measuring the Impact" (Richmond, VA: Virginia Department of Housing and Community Development, June 1987).

The Ybor zone (Tampa, Florida) officials and merchants concur, believing the marketing and promotion of their zone helped the area retain existing firms and attract new businesses.[27]

Local Role

Subject to state approval, the responsibility for determining zone boundaries rests with local authorities. As stated previously, the process of setting boundaries is arbitrary. This has led local authorities to gerrymander zone boundaries to suit their needs, including extending benefits to non-blighted regions and areas without residents. When initially designated in 1983, the Louisville, Kentucky enterprise zone covered 3.8 square miles of a blighted neighborhood near the center of the city. Four years later, the zone was extended over 13 miles to include a more affluent area in nearby Jefferson County that did not qualify for designation. Not surprisingly, new and mobile businesses chose to locate in the suburban county, as opposed to the downtown area.[28] Louisville's expansion is an exception but illustrates the difficulties of confining enterprise zones to depressed neighborhoods.

States usually do not dictate the level of required local commitment, nor do they specify which incentives are best suited for local conditions. Although this allows local governments flexibility in designing a development package, their financial means limits their capacity to put together an optimal economic development package. With the exception of the property tax, the mainstay of local government revenue, the capacity of local governments to offer tax concessions is restricted. A consequence of a significant property tax concession may be a decrease in the ability of the government to provide services and amenities, which hastens a blighted area's decline. Despite this, in the absence of alternatives, most local governments offer property tax breaks to zone businesses.

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[27] U.S. Department of Housing and Urban Development, "State-Designated Enterprise Zones," p. 182.

[28] Steven A. Holmes, "Enterprise Zone Test Shows Room for Growth," New York Times, October 31, 1990.

Non-tax incentives offered by local governments may be more significant than property tax reductions in helping zone businesses. Local inducements include decreasing or exempting zone businesses from user and permit fees, relaxing zoning regulations, reducing utility rates, offering technical assistance, supplying economic and development/rehabilitation loans, and improving police protection, sanitation facilities, roadways, school systems, and other local services. Provided they have the resources, improvements in services, amenities and the infrastructure may be the most important contribution local governments can give a zone. Cities and counties plagued with dilapidated areas, however, rarely have the financial resources needed to provide extra assistance. Local governments often turn to state and federal governments when undertaking infrastructure projects and other improvements. This reemphasizes the importance of direct expenditures from the state and federal government for enterprise zone.

Analyses of state enterprise zones found local commitment to the enterprise zone program essential to their viability. Local authorities and organizations, even if poorly funded, are able to galvanize support for the program and represent the community favorably to potential zone businesses. They facilitate communications between local and state governments, neighborhood organizations, and the private sector. These studies claim zone designation and the involvement of local officials and businesses may be more important to a zone's success than the tax incentives offered by states and localities.[29]

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29 Erickson and Friedman, p. 94; Ann Workman Sheldon and Richard C. Elling, "Michigan's Enterprise Zone Program: Progress, Prospects, Problems and Recommendations" (Detroit, MI: Wayne State University, April 1988); Hornbeck, p. 17; Housing and Urban Development, "State-Designated Enterprise Zones: Ten Case Studies," p. xiii.

EXPERIENCES OF FIVE STATES

Several state agencies and individual researchers have attempted to evaluate the impact of overall zone experiences as well as the role of specific program components. The enterprise zone operations of Michigan, Virginia, Maryland, Indiana, and New Jersey are singled out for brief review. They represent a cross section of zones from the northeast, mid-Atlantic, and rustbelt states, and their programs have been in operation at least five years. The zone experiences of the states are discussed in order ranging from the least effective to the ones deemed most successful. Michigan's first attempt at an enterprise zone program, which is distinct from the others, can be considered a futile attempt to rehabilitate a blighted area; but Michigan has learned from its initial mistake and revised its program. New Jersey's program, in contrast, has been hailed by its supporters as a "success."

These states were selected for review because of the availability of information about their operations, although the quality of the data leaves much to be desired for several reasons. First, most zones have, at best, limited statistical records prior to designation and few, if any, have collected truly reliable data since designation. Before and after comparisons are therefore of little validity. Second, zone coordinators have a vested interest in proclaiming success of their efforts, casting doubt on the data they supply, while independent verification does not exist. Third, the data collected by zone coordinators are often irrelevant, failing to reveal how the community benefited from the claimed increased economic growth. Employment statistics, for example, do not show what percentage of new hires are zone residents or a result of enterprise zone activities. Many analysis of zone experiences fall short of indicating if the area experienced increased investments prior to designation or compare the zone's growth to that of surrounding areas. The review of state enterprise zones is based on experiences in the mid 1980s, when the nation experienced continued national economic growth. Distinguishing between growth due to enterprise zone incentives and investments that would have occurred without the incentives is necessarily speculative.

Despite these caveats, some insight can be gleaned from evaluations of zone experiences. One study surveyed 30 states and found 55 percent of all investments came from expanding businesses located in the zones prior to their designation.[30] Studies of New Jersey, Indiana, and Virginia zones reinforced this estimate. They found 69 to 85 percent of investments in these state zones resulted from the expansion of indigenous businesses.[31] The scarce data prevented the analysts from determining whether the expansions occurred independent of zone activities or if the areas were experiencing economic recovery before designation.

Twenty-five percent of zone businesses were small or start-up firms. The studies found that few small businesses benefitted from the tax expenditures offered by the states because the tax concessions had little impact on their investment or locational decisions. Nearly half of the firms in New Jersey's zones with less than 10 employees reported that their investment decisions were not influenced by zone benefits. Apparently middle size or larger firms reap a majority of the financial savings. In Indiana, for example, companies with more than 100 employees accounted for one-tenth of the enterprise zone businesses, but they received 54 percent of the tax breaks given by the state.[32]

Michigan

Michigan's first attempt at an enterprise zone program was a complete failure. Begun in 1986, the state designated only one enterprise zone, the entire city of Benton Harbor. The program offered qualified businesses three tax

30 Erickson and Friedman, p. 57.

31 Marilyn M. Rubin and Regina B. Armstrong, "The New Jersey Urban Enterprise Zone Program: An Evaluation" (Wayne, NJ: Urbanomics, July 1989), p. 24; James A. Papke, "The Role of Market Based Public Policy in Economic Development and Urban Revitalization: A Retrospective Analysis and Appraisal of the Indiana Enterprise Zone Program, Year Three Report" (West Lafayette, IN: Purdue University, August 1990), pp. 4, 6; Virginia Department of Housing and Community Development, p. 7.

32 Rubin and Armstrong, p. 26; Papke, p. 4.

breaks: an exemption from the state's single business tax; an exemption from state sales and use taxes; and relief of 60 percent from local property taxes. (Benton Harbor's property taxes are extremely high when compared to the property taxes of contiguous communities). The state reimbursed the city for losses in property taxes by augmenting its payments to the Benton Harbor School District. A qualified business under the original enterprise zone program included new businesses locating in the city and old businesses that doubled their investments in the zone. The original legislation also limited the time period in which firms could qualify for these tax subsidies to two years from the date of designation. After the initial two years, the time period was extended an additional two years.

Several studies conducted during the zone's first years were critical of the program.[33] These studies found Michigan's enterprise zone policies to be ineffective tools in alleviating the city's economic problems because few businesses were willing or able to participate in the program. By the end of the program's first four years, only 25 firms were designated to receive benefits. The studies listed several reasons for the lack of interest in the program. First was the program's emphasis on attracting new or relocating firms, as opposed to assisting existing and indigenous firms. In addition, few business owners knew of the program. Those who did, perceived enterprise zone policies as being useless because they did not address the causes of the city's problems and because zone policies relied on larger "outside" firms to revive the local economy.[34]

Second, the tax incentives were inadequate to influence businesses to relocate or start in Benton Harbor. The competitive tax rates were ineffective because Benton

[33] Sheldon and Elling; Michigan Departments of Commerce and Treasury, "Analysis of the Benton Harbor Enterprise Zone: A Review of the First Three Years" (Lansing, MI: Michigan's Department of Commerce, Department of Treasury, October 1989); The Brand Consulting Group, "Benton Harbor Opinion Leaders' Reaction to the Local Economy and Enterprise Zone" (Lansing, MI: November 1988).

[34] The Brand Consulting Group, pp. 17-18.

Harbor's problems go beyond its high tax rate. The city has suffered for over three decades from chronic high unemployment and economic decline. The deteriorated state of public services and lack of local support for the program have made it an extremely risky place for investment despite zone inducements.

Since the program was not readily accessible to most businesses, its cost to the state during 1989 was estimated to be only $350,000 for additional payments to the Benton Harbor School District, and $25,000 in forgone revenue from the single business tax. The revenue loss from the exemption of property from sales and use taxes was insignificant. These expenditures accounted for 141 new jobs, over half of which went to Benton Harbor residents. Interestingly, several firms invested in Benton Harbor but did not receive tax breaks, either because they did not qualify or they did not know of the program. The existence of unsubsidized investment indicates zone policies may not have been solely responsible for even the marginal increase in the city's economic activity.[35] Benton Harbor's economy bottomed out in the early 1980s and began a slight recovery in the mid to late 1980s. Determining what growth was a direct result of zone policies given the changes that occurred in Benton Harbor, and continue to occur, is nearly impossible.

Michigan's enterprise zone program was an acknowledged failure. Responding to the critical studies, the state revised its enterprise zone policies in 1990. In addition to extending the application time period to 1994, the revised program expands the opportunity for existing businesses to receive tax credits. The new law reduces the investment required of expanding firms to qualify from 100 percent of the current investments to 50 percent. Expanding firms that do not meet this new limit may receive property tax credits equal to the amount they spend on property improvements or increased wages on zone residents. Benton Harbor also established a revolving loan fund to provide capital and loans to local businesses.[36]

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35 Michigan Departments of Commerce and Treasury, p. 13.

36 Michigan Department of Commerce, Michigan Enterprise Zone Authority, "Michigan Enterprise Zone Program Impact

Within the first year of the revised legislation, 84 firms were designated to receive zone benefits. Fifty-seven of the 84 firms were new to Benton Harbor, ten of which relocated from elsewhere.[37] An additional 36 expanding firms qualified for property tax credits. Despite all this activity, it is difficult to relate Benton Harbor's improving economic outlook solely to enterprise zone policies. As one study concluded, "The enterprise zone, by itself, cannot cause an economic renaissance in Benton Harbor because the barriers to economic development in the city go far beyond high taxes. . . but it can play a central role in a comprehensive development strategy..."[38] The new enterprise zone program, in coordination with a comprehensive economic development program, may be just what the city needs to maintain a slow but steady recovery.

Virginia

Virginia initiated its zone program in 1984. To qualify, a potential zone had to exceed the state's average unemployment rate by 50 percent, or 25 percent of its households had a median income below 80 percent of the area's median income. The state offered businesses three tax incentives, which phased out over a five year period. They were a credit on the state business income tax, beginning at 80 percent; a tax credit equal to the amount of the firms' state unemployment insurance tax liabilities; and an exemption from sales and use taxes on equipment used in zone businesses.[39]

The Virginia Department of Housing and Community Development analyzed the effectiveness of state enterprise zones in generating economic growth. During the first three and a half years of the program 28 of 3,720 firms operating in the zones applied for credits. The dismal

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Analysis: September 1989-August 1991," unpublished draft, October 1, 1991, pp. 58.

37 Ibid., p. 7.

38 Michigan Departments of Commerce and Treasury, pp. 21-22.

39 Virginia Department of Housing and Community Development, p. 1.

participation rate can be attributed to the lack of support and promotion the state provided its enterprise zone program. First, the state demonstrated a limited interest in the program. It failed to create a single administrative position to oversee or promote the program, and provided only minimal assistance to local authorities. Second, community participation was not a prerequisite to qualify as a zone. Without local support, there was no energizing force within the communities to advance the program. Third, paperwork to qualify for benefits was cumbersome. The state required participating firms to hire an independent CPA to prepare the qualifying paperwork. Firms that learned about the tax breaks may have decided not to apply because the potential benefits were not commensurate with the cost of the application.

The Virginia enterprise zone program is a case where the state passed a law but left to the zones with nominal resources. The state-sponsored assessment concluded that "state incentives were never intended to accomplish the objectives of this program by themselves. They complement the local incentives provided by each zone..."[40] The state offers meager help while the localities are supposed to provide the development tools. Local governments have offered an array of incentives including: the reduction/ elimination of permit fees and property taxes; development/ rehabilitation loans; capital improvements; job training; improved traffic control and public transportation; and improved police protection. Businesses in only 5 of the 12 zones applied for state benefits, but businesses in every zone utilized local incentives. A "positive" conclusion of the report was the program's negligible costs. State outlays for the program during its the first two years amounted to $172,000. The costs were low, but so were its results.

Maryland

Maryland began operating the first of its 15 zones in late 1982. To qualify for designation, zones had to meet one of the following four criteria: an unemployment rate 50 percent above the state's or nation's average; a poverty rate at least 1.25 times the national average; a decline in population of at least 10 percent between 1970-1980; and an average

40 Virginia Department of Housing and Community Development, pp. 9-10.

income less than 80 percent of the state median income for 70 percent of households in the zone. The state does not require its zones to have a minimum population, and at least five industrial parks designated as zones have no residents but are contiguous to qualifying areas.

The state offers zone businesses a property tax credit equal to 80 percent of the taxes assessed on improvements in real property for five years and declining tax credits for the next five years. It also provides an income tax credit of $500 for each newly created full time job and $1,500 for each new job filled by a disadvantaged person. The credit is phased down to $1,000 in the second year and $500 in the third year. In addition, the state created a $2 million venture capital fund to guarantee loans made to zone businesses.[41]

A General Accounting Office (GAO) assessment of Maryland's enterprise zone program in three non-urban zones reemphasized the difficulty of determining economic growth resulting from zone designation. The GAO contended that investments and employment increases in the three zones could not be attributed to the state program, but in a seemingly contradictory statement it also concluded that the program played a significant role in the hiring and investment decisions of existing firms.[42] As part of its analysis, the GAO compared employment patterns before and after designation. As stated earlier, before and after comparisons provide suspect results. The Maryland department of Economic and Employment Development found fault with GAO's findings for other reasons. First, the GAO surveyed only rural areas, whose employment patterns are often seasonal. Second, in one zone, Cumberland, the largest employer (with 1,000 employees) was excluded from GAO employment calculations because of its fluctuating

41 Maryland Department of Economic and Employment Development, "The Maryland Enterprise Zone Program: A Progress Report and Response to GAO" (Annapolis, MD: Maryland Department of Economic and Employment Development, April 17, 1989).

42 General Accounting Office, "Enterprise Zones: Lessons from the Maryland Experience" (Washington: General Accounting Office, December 1988), pp. 3, 5, 42.

employment patterns. Third, Maryland charged that the GAO ignored the job retention achievement of the zone program. The state administration, however, did not estimate the impact of enterprise zone incentives upon job retention.

Compared to contiguous areas, investments and employment in several of Maryland's zones increased. Much of the growth, however, was a direct result of state and federal government expenditures unrelated to zone operations. For example, Baltimore's Park Circle Industrial Park, which was touted as a successful zone endeavor by the Reagan administration, received $5.5 million in federal and state funds for site improvements.[43] The effectiveness of tax subsidies alone in helping promote economic development in Maryland is doubtful. Only after venture capital and block grants were used to improve the areas were tax incentives used to promote economic activity.

Indiana

Indiana designated the first of its 10 enterprise zones on a competitive basis in 1983. To qualify, the unemployment rate in an area had to be 50 percent above the state's level and the average income 25 percent below the U.S. average. In making its selections, the state considered the presence of an urban enterprise association and to the degree of local commitment to the program. Indiana's program offers employers a local property tax credit for 100 percent of the inventory stored in the zone and a 10 percent tax credit for wages paid to zone residents with a cap of $1,500 per worker. Non-employer tax credits are a 30 percent reduction of personal income taxes for capital invested in zone businesses, a five percent tax credit on interest earned from loans to zone firms, and an income tax credit to employed zone residents of about $225. The state also established a $2 million industrial development fund for financing enterprise zone projects.

Several researchers studied the effects of Indiana's incentives on zone development.[44] The analysts found that

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[43] James Traub, "Urban Enterprise Fraud," The New Republic, October 18, 1982, pp. 11-14.

[44] James A. Papke and Leslie E. Papke, "State-Local Concessions as Urban Redevelopment Tools: Incentives, Subsidies or Windfalls?" (West Lafayette, IN: Purdue

the zones experienced economic growth, but they also concluded most of the expansion was not due to the tax incentives. One study speculated that zone designation was a prerequisite to establishing the mechanisms needed for initiating growth, but also stated "... financial or regulatory incentives, by themselves, are very unlikely to lead to the success of the enterprise zone."[45] Another analyst expressed stronger doubts about the effectiveness of Indiana's zone subsidies. "Non-targeted capital subsidies," he stated, "are expensive and of questionable effect in stimulating investment in economically depressed inner cities... Continuation of mismatches between [the needs of] zone employers and zone resident workers, as indicated in the Indiana experience, only perpetuates the chronic unemployment and poverty incomes problems of the inner-city."[46] The researchers listed several shortcomings.

First--underutilization of wage credits. Despite the generous tax credit offered to employers for hiring zone residents, only 14.7 percent of new employment in 1988 went to zone residents and zone residents accounted for only 7 percent of total employees working in Indiana's zones. The residents in the zones did not possess the skills needed for most of the new employment generated by zone operations, and they earned substantially less than non-zone residents. In 1988, zone residents earned annually an average of $11,746 compared with the annual average wage of $20,434 for all zone employees.[47]

Second--overutilization of the tax credit for inventory. The inventory tax credit accounted for 87 percent of the tax saving by businesses but was ineffective in generating new jobs and had little potential of doing so in the

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University, November 1990); Barry M. Rubin, "Urban Enterprise Zones in the Upper Great Lakes: A Case Study and Analysis of Indiana's Experience" (Indianapolis, IN: Indiana University, August 1990); Barry M. Rubin and Margaret G. Wilder, "Urban Enterprise Zones: Employment Impacts and Fiscal Incentives," APA Journal, Autumn 1989, pp. 418-431.

45 Rubin, pp. iii-iv.

46 Papke, pp. 23-24.

47 Papke and Papke, pp. 4-8.

future.[48] The studies claimed that the inventory tax credit was wasteful because it did not encourage revitalization, was uncapped, and ended up as a windfall to businesses. The Indiana House committee voted to eliminate the enterprise zone inventory tax credit.[49] The full legislature, however, decided not to change its original zone legislation.

One study applied a shift-share analysis to determine the external causes of growth or decline in the Evansville zone by isolating the changes due exclusively to zone activities. The researchers compared the economic growth of the Evansville zone with the Evansville metropolitan four county area. The study found that only 17 percent of the increase in zone employment was due to general growth in the metropolitan area but could not find a direct relationship between the incentives and job growth. None of the studies were able to find a direct relationship between tax incentives and hiring or investment patterns, yet the enterprise zones did experience greater growth than comparable non-zone areas. The analysts conjectured that designation, in and of itself, was a motivating force in stimulating new economic activity and might have been responsible for the unexplained growth of the Evansville zone.[50]

New Jersey

New Jersey designated the first of its 12 competitive zones in 1984. Eligible areas had at least 2,000 unemployed residents and one of the following: an unemployment rate at least 50 percent above the national average; 20 percent of its households below the poverty level; or 20 percent of its residents on public assistance programs. Nineteen areas applied for designation, and the 12 areas with the highest potential for success and a convincing degree of commitment by local, public, and private organizations were chosen.

The state offers qualified zone businesses tax credits of $1,500 for each new full time employee who received public assistance 90 days prior to employment and a $500 tax

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48 Papke, p. 10.

49 Eugene Carlson, "Impact of Zones for Enterprise is Ambiguous," Wall Street Journal, April 1, 1991, p. B-1.

50 Rubin and Wilder, pp. 419, 422, 427.

credit for other zone residents. A qualified business is either a business located in the zone prior to designation and authorized to do business in the state or a business that moves into a zone after designation and 25 percent of its new full-time employees are either zone residents, unemployed for the past year, or low income persons eligible to participate in the federally funded jobs training program. Other major tax benefits include the exemption from state sales and use taxes of tangible personal property, materials, and services for construction related activities on real property; a 50 percent rebate on unemployment insurance taxes paid by employers for new employees earning less than $18,000 a year; and in five of the state's 12 zones retailers may reduce state sales tax by 50 percent on many retail items.[51]

New Jersey implemented its enterprise zone legislation when the state was experiencing rapid economic growth, making it difficult to determine what investment and employment was a direct result of zone benefits. One study attempted to identify the investment decisions based primarily on zone benefits. To derive such data the analysts had to rely upon subjective estimates of employers. The researchers reported that during 1987 and 1988 zone businesses created 3,948 new jobs and contributed $38.6 million in direct state and local taxes at a cost to the state of $51.6 million during the tax year.[52] Considering potential multiplier effects, the findings are seemingly impressive. While the analysts surveyed businesses as to the importance of the tax subsidies in their investment decisions, their discussion did not determine what investment and development would have occurred without zone designation. Given that New Jersey grew economically during the 1980s, this omission is significant. The analysts also did not obtain data on the portion of new jobs filled by zone residents or how the investments benefited the community.

The study estimated that cost per job ranged between $8,000 - $13,000. This, however, only represents the costs of the program in 1987 and 1988. Job growth will peak before investment does. This will translate into inflated costs for the

51 Rubin and Armstrong, pp. 5, 17.

52 Rubin and Armstrong, p. 6.

program. One researcher speculated that during the next decade the cost per job will be $40,000 - $60,000, although the analyst acknowledged that the estimate may be on the high side. It appears that in the long run the New Jersey program will be costly.[53] The potentially rising costs of providing tax credits accentuates the need of timely termination of enterprise zones or caps on their funds.

In 1989 New Jersey expanded the Jersey City enterprise zone by 151 acres, eliminating approximately 549 acres of the original zone and adding about 700 new acres. The expanded zone includes most of Jersey City's shopping districts and several industrial parks, qualifying their businesses for zone benefits. Prior to the expansion, only one shopping mall on the waterfront was included in the zone. The waterfront area also received urban development block grants and state funds to assist in its redevelopment. Many Jersey City merchants complained that the waterfront businesses received most of the city's financial aid when the other parts of the city also had economic problems. The equity issue is one reason why Jersey City did not want the initial Jersey City zone to offer reduced sales tax rates. Since the zone now incorporates all its major shopping districts, Jersey City has petitioned the state zone board for authorization to offer reduced sales taxes. The board has yet to act on the request because merchants from neighboring townships are concerned about the negative impact the sales tax reduction would have on their business.[54] This experience illustrates some of the economic and political problems associated with singling out a small section of an economic market for special benefits.

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53 Franklin J. James, "Evaluation of Enterprise Zone Programs," in Enterprise Zones: New Directions in Economic Development, Roy E. Green (ed.) (Newbury Park, CA: Sage Publications, 1991), p. 228.

54 Joseph Albright, "Urban Zone Expanded: Taxes to Fall," Jersey Journal, May 9, 1991, A-1; Edward K. Shanahan, Miri Ascarelli, and Lisa Torbic, "UEZ Expansion Worries Some," Jersey Journal, May 10, 1991, A-1.

Lessons Learned

The brief review of enterprise zone experiences during the past decade yields some tentative observations. Assuming states want to start or continue experimenting, they need to determine whether a zone's potential for growth should be a controlling factor in designating areas. Indiana and New Jersey favored areas with a strong potential for becoming economically viable. Their policies promised a high probability of "success" but excluded the most needy areas. Michigan selected an extremely depressed area and tax incentives alone failed. If the federal government should embark on an enterprise zone initiation and decides to assist the most blighted areas, it would need to sharply limit the number of eligible zones because such communities would require relatively large investments to vitalize their economies. Focusing on the needs of the most blighted areas will diminish potential support for the program because "success" will be hard to demonstrate and more viable areas would resent spending a disproportionate share of the program's resources on the poorest areas.

The ability of small businesses to utilize investment oriented tax incentives is questionable. There is little indication from both the British and state experiences that small businesses are able to take advantage of most tax concessions. Only concessions on sales taxes were found to be useful to small businesses. They normally receive their initial capital from friends, family, and occasionally from the Small Business Administration, not through investments in their stock. The benefits of decreased capital gains to small businesses is at best marginal and non-existent in most cases. In addition, most small businesses cannot use tax credits unless they are refundable. Many do not incur the tax liabilities needed for tax credits. This presents strong doubts whether small businesses have been able to take advantage of state programs. Because small businesses may not be able to partake in the incentives, they may be placed at a competitive disadvantage with the larger, established firms that receive the subsidies.

The employment and training of zone residents, particularly the disadvantaged, should be a prime consideration for implementing enterprise zone policies. Forty percent of unqualified businesses operating in New Jersey's zones claimed that to operate profitably they could

not meet the requirement of hiring 25 percent of their work force from zone residents. The surveyed firms indicated that a better trained workforce would improve business conditions in zones.[55] In the absence of an educational and basic skills training program, the deficiently educated and the unskilled who should be prime targets for assistance will not benefit from the program. From a macroeconomic view, enterprise zones policies created few new jobs or businesses. The majority of the new businesses that moved into state enterprise zones were either relocating firms or businesses that would have started without government incentives. The jobs they created would have existed without the subsidies, but might have been situated outside the zone. Zones' gains were other areas' losses.

The limited tax resources of the states is a serious impediment to implementing successful enterprise zone programs. Excluding unemployment insurance payroll taxes, state taxes account for at most five percent of total business expenses, which sharply limits the tax credits states can offer. In contrast, federal taxes can be a more powerful vehicle for offering subsidies to zone businesses and employers. Federal taxes are also more progressive than state or local taxes, allowing the federal government greater flexibility in offering tax concessions.

Whatever the value of states as laboratories for social experimentation, their zone policies and programs strongly indicate that states are ill equipped to revitalize blighted areas alone. Only the federal government has the available resources and a broad selection of tools. It does not follow, however, that the allocation of resources for a zone policy would be a cost effective initiative. The antipoverty programs already in existence are examples of human resource programs able to help people in blighted areas. A judicious expense of these efforts and the creation of jobs for the poor wherever they reside is likely to prove a more effective approach to attacking the deep-seated problem of inner city and rural poverty than experimenting with unproven and doubtful programs.

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55 Rubin and Armstrong, pp. 29-30.

EMPOWERMENT: A VISION BASED ON FAITH

Conceptually enterprise zones are an attractive urban policy. They seem to offer an innovative means and target strategy for revitalizing depressed areas. The Bush administration has associated enterprise zones with the politically alluring concept of empowerment, a buzzword currently in vogue by fiscal conservatives wishing to help the poor. Using a free-market-driven approach, advocates claim they are bestowing power on the poor that will enable them to forge their destinies. This is to be achieved by freeing them from the shackles of government bureaucracy.[56] The rhetoric surrounding enterprise zones distorts reality and tends to obfuscate the needs of blighted areas and the real costs of their rehabilitation. Empowerment cannot be achieved on the cheap and is not a substitute for direct help.

Aside from the magnitude and type of incentives a viable enterprise zone initiative would offer, a serious impediment to a successful program is the designation process of the zones. Placing limits on the number of areas receiving federal aid creates political problems. Every member of Congress would want his or her district or state to receive a fair share of the federal funds appropriated for enterprise zone. Past federal programs that were geographically targeted, e.g. the Area Redevelopment Act and the Model Cities, were expanded to include a much larger number of areas then originally intended. The ARA program was initially envisioned to help a few dozen areas. By the time President Kennedy signed the bill into law, one of five counties qualified, and a year later over one-thousand counties were included in the ARA programs. Originally designed for three cities, the model cities program ballooned to encompass over 120 cities. Although expansion of the ARA and model cities programs were a political necessity for securing congressional passage, it diminished the ability of these programs to achieve their goals by spreading resources thinly. State experience offers other innovative ways for expanding eligibility. Kentucky and New Jersey expanded

56 Jason DeParle, "Kemp's Proposals on Poverty Given Sympathy, Not Action," New York Times, July 1, 1991, A-1.

their zone areas to include relatively affluent areas. This too detracts from the original purpose of the program, helping depressed areas.

Passage of enterprise zone legislation faces the same fate. Besides HR.11 and 23, two other bills have been introduced in the current Congress. The Rural Development Investment Zone Act (HR.1445) would authorize 100 zones in rural areas and the Indian Economic Development Act of 1991 (S.383) would establish enterprise zone demonstration projects on 12 Indian reservations. While the needs of impoverished rural areas and Indian reservations are not in question, the new bills indicate the likelihood that an enterprise zone program, if enacted, would repeat the experience of earlier federal legislation addressed to aid depressed areas. State experience reinforces this concern. Illinois' state legislators were unable or unwilling to deny zone benefits to most areas that petitioned the state. Having started out with a generous number of 48 zones, the state now possesses double that number.[57] The original rationale for an enterprise zone initiative was to target assistance to truly blighted areas, but history shows that in a political arena, achieving this goal is difficult to impossible.

If Congress succeeds in placing a limit on the number of areas eligible for designation, federal officials will have to pick and choose among qualified areas because pending legislation does not establish rigorous criteria for designation. The selection of zones will offer difficult decision for officials. If they choose areas with potential for redevelopment, the most needy and poorest areas will be bypassed by the program because they are the least likely to succeed. State experiences with enterprise zones suggest that the most blighted areas have been left out of their programs. In either case, areas in extreme distress are unable to take advantage of enterprise zone benefits, casting doubt about the viability of the concept.

The overall effectiveness of a federal enterprise zone program is also problematic. Pending bills do not address a

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57 Ken D. Redfield, "Enterprise Zone in Illinois" (Springfield, IL: Sangamon State University, December 1990).

principal cause of distress--the idleness or waste of the residents of the blighted areas. "Empowering" zone residents requires that they be economically self-sufficient. For this to happen, residents need to be able to compete effectively in the labor market. Tax expenditures offered by the pending federal enterprise zone bills will not accomplish this nor will they provide the mechanisms needed to "empower" zone residents. Many of the residents lack the basic skills needed for most jobs. They are in need of basic education and skill training, which requires direct expenditures. None of the pending bills addresses the major reasons for the deprivation in blighted areas, and the proposed assistance is not likely to succeed in combating urban blight.

The initial advocates of an enterprise zone initiative argued that the program will be costless; the incentives will create new net investments that will more than compensate the government for the tax expenditures. The same people also promised the 1981 tax cuts would raise federal revenue and reduce the national deficit. There is no indication from state or British experiences that federal enterprise zones will increase federal revenue. Empirical evidence indicates that while some existing firms expanded their operations, investments by other businesses are location shifts from one site to another. Business start-ups have not significantly increased in state zones and are unlikely to do so in federal zones. The most a federal enterprise zones program can hope for is a zero-sum gain as investments are transferred from non-zone areas to zones. The redistribution of investments could have a detrimental effect on neighboring areas, except when a business leaves a full employment area, which is a rarity these days. Most blighted areas are surrounded by neighborhoods whose economies may be only marginally better or even worse than that of the zones. Directing investment away from marginal areas to blighted areas may destabilize contiguous areas.

In the real world an effective enterprise zone program will require direct expenditures. Stuart M. Butler, a staunch advocate of enterprise zones, argues that an attractive tax and regulatory climate is only one precondition for economic development. Testifying before a congressional subcommittee he stated, "Other ingredients are required if economic development is to occur...Action needs to be

taken...to tackle the staggering increase in drug use and crime within the inner cities..."[58] These "other ingredients" will not come free and without them, tax incentives alone will fall far short of inducing business to expand or relocate in enterprise zones. State experiences have shown that improvements in the physical appearance, services, and infrastructure are extremely important to reviving an area.

Reliance on the private sector to correct the ills of blighted areas is a hope lacking empirical evidence. It is not the responsibility of the private sector to improve the physical and human infrastructures of decayed areas. In fact, the private sector abandoned these areas for more attractive and safer environments in the suburbs, which exacerbated the deterioration of inner cities, and impoverished rural areas. Tax reductions and relaxing regulations alone will not bring businesses back to depressed communities, and tax expenditures are not without their costs. Cuts in taxes translate into lost government revenue on top of unprecedented deficits. This will be met either by a reduction in the services provided by the government or raising revenues. In either case, the community pays for the tax cuts.

Past attempts to aid distressed areas at both the state and federal levels have demonstrated the complexity of the problems within blighted areas. If the federal government is serious about combating blight, it needs to address economic deprivation wherever it exists and at its causes. The deep-seated problems of inner cities and empoverished rural areas cannot be easily alleviated, although it can be argued that every little bit helps. As currently proposed, however, the alleviation of blight in one area is likely to come at the expense of contiguous areas. Robbing Peter to pay Paul has been tried before but is hardly a model for a new initiative.

If Congress chooses to enact an enterprise zone initiative, it should shift the legislation's focus to directly helping the residents in the community. Assisting these residents entails improving their education, skill levels, as

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58 Testimony of Stuart M. Butler before the U.S. Congress, House Committee on Ways and Means, Subcommittee on Select Revenue Measures, Hearing on Enterprise Zones, June 25, 1991.

well as their physical surroundings. The residents have to acquire skills and an education. Once the individuals are able to compete effectively for employment, it will not be necessary to bring job opportunities to their backyards. Equipped with the necessary skills, they would be able to travel outside the zone to earn a living. Improvements in the amenities and infrastructure should include at least transportation facilities, police protection, and the educational system. This is the most effective strategy to empowering the residents of blighted communities.

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